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APPLICATION OF

**ROBERT A. WINNEY D/B/A
THE WATERWORKS COMPANY OF
FRANKLIN COUNTY**

CASE NO. PUE000665

To change rates and charges

REPORT OF ALEXANDER F. SKIRPAN, JR., HEARING EXAMINER

February 21, 2002

Robert A. Winney began this case by informing customers of his intent to increase rates for his water company for the first time since 1989. Water customers of Mr. Winney brought the proposed increase in rates to the Commission's attention. After conducting its investigation into the cost and operation of Mr. Winney's water company, Staff recommended a decrease in rates. In response, Mr. Winney attempted to withdraw his proposed increase and failed to appear at the evidentiary hearing scheduled for this matter.

HISTORY OF THE CASE

In a notice sent to customers on November 13, 2000, Robert A. Winney d/b/a The Waterworks Company of Franklin County ("Waterworks" or "the Company") notified customers of his intention to increase the Company's rates and charges as of January 1, 2001. As stated in the notice, Mr. Winney planned to (i) increase the quarterly rate for water service from \$67.50 to \$75.00; (ii) increase the annual availability fee from \$60.00 to \$75.00; and (iii) establish a connection fee of \$1,000.00. On November 20, 2000, a customer of the Waterworks provided the Commission's Division of Energy Regulation with a copy of Mr. Winney's notice.

On December 12, 2000, the Commission issued an Order for Notice and Hearing in which it docketed Mr. Winney's proposed rate increase; suspended the proposed increase through March 1, 2001; designated the proposed increase as interim and subject to refund on and after March 2, 2001; scheduled a public hearing for March 20, 2001; and assigned the matter to a hearing examiner.

By letter filed on March 12, 2001, Mr. Winney requested leave to withdraw the application. On March 13, 2001, the Commission's Staff, by counsel, filed a response opposing the request to withdraw. Staff states that in its testimony and exhibits filed on March 5, 2001, Staff identified numerous aspects of the Company's operations and finances, which warrant Commission review. Staff further argued that this matter should proceed to hearing so that a full record may be developed on the Company's current financial position and its rates, charges, and service.

A Hearing Examiner's Report dated March 16, 2001, granted Mr. Winney's request to withdraw the application and invited Staff to seek a Rule to Show Cause. However, on July 6, 2001, the Commission entered an Order Remanding Case to Examiner and directed that

the matter be rescheduled for hearing. A Hearing Examiner's Ruling dated August 22, 2001, established a new procedural schedule and scheduled a public hearing for this matter for November 15, 2001.

On November 15, 2001, the evidentiary hearing was convened as scheduled. No one appeared on behalf of Waterworks. Wayne N. Smith, Esquire, represented the Staff. No public witnesses appeared at the evidentiary hearing. Filed with this Report is a transcript of the hearing.

SUMMARY OF THE RECORD

Waterworks provides unmetered water service to fifty-four customers and collects an availability charge from the owners of thirty-one other lots.¹

On January 4, 2001, Mr. Winney filed a letter with the Commission complaining about the attitude of the Staff towards the Company and demanding an explanation for delaying the requested rate increase for Waterworks.² Mr. Winney stressed that he provided customers with proper notice and that the rates for Waterworks have remained the same since 1989.³ Mr. Winney contended that "[t]here is **no reason why the SCC has decided to single us out to have a hearing on this matter.**"⁴

On March 5, 2001, Staff prefiled the testimony of Patrick W. Carr, principal public utility accountant with the Division of Public Utility Accounting, and John A. Stevens, a utilities engineer with the Division of Energy Regulation. Mr. Carr conducted an audit of Company documents and records in order to construct a per books rate of return statement for the test year ending November 30, 2000.⁵ Mr. Carr found that the Company on a per books basis, lost \$323 during the test period.⁶ Mr. Carr noted that the Company failed to maintain its records in accordance with the Uniform System of Accounts ("USOA") for Class C water utilities as ordered by the Commission in Case No. PUE970119.⁷ In response, Mr. Carr asked that the Company be ordered to abide by the Commission's earlier ruling.⁸

After constructing per books figures for the Company, Mr. Carr then made the following twenty-one adjustments.

¹ Exhibit PWC-2, at 1, Appendix at 1.

² Exhibit Company-1.

³ *Id.*

⁴ *Id.* (emphasis in the original).

⁵ Exhibit PWC-2, at 2.

⁶ *Id.* Statement I.

⁷ *Id.* at 3.

⁸ *Id.*

Adjustment No. 1. Revenue Annualization

Mr. Carr annualized water revenue based on the number of customers served at the end of the test period, multiplied by the currently approved rate.⁹

Adjustment No. 2. Remove Loan Proceeds.

Mr. Carr removed from revenue, the proceeds from two personal loans from Mr. Winney to the Company.¹⁰

Adjustment No. 3. Remove Loan Payments.

Mr. Carr eliminated from operating expenses the payments made on two alleged loans.¹¹ First, Mr. Carr was unable to document whether the alleged loans were in fact loans as opposed to equity contributions by Mr. Winney.¹² Second, Mr. Carr calculated that even if the loans were legitimate debt transactions, cash withdrawn from the Company by Mr. Winney since April 1, 1997, was more than enough to pay off these loans.¹³

Adjustment No. 4. Salary Expense.

Mr. Carr increased operating expenses by \$5,000 to include a salary for Mr. Winney.¹⁴ Nonetheless, Mr. Carr recommended that the Commission order the Company to maintain time records for all Company owners and employees to support and justify salaries in future cases.¹⁵

Adjustment No. 5. Include Other Cash Expenses.

Mr. Carr increased operating expenses by \$199 to reflect cash expenses of the Company paid directly by Mr. Winney.¹⁶ Most of these expenses appear to be for gasoline for the Company's vehicle.¹⁷ Mr. Carr recommended that the Company be required to maintain a mileage log for its vehicle.¹⁸

Adjustment No. 6. Bad Debt Expense.

During the test period, the Company was unable to collect revenues from one usage customer and thirteen availability customers.¹⁹ Because the Company does not have the funds to

⁹ *Id.*

¹⁰ *Id.* at 4.

¹¹ *Id.* at 4-6.

¹² *Id.* at 5.

¹³ *Id.* at 6.

¹⁴ *Id.* at 6-7.

¹⁵ *Id.* at 7.

¹⁶ *Id.* at 7-8; Appendix at 3.

¹⁷ *Id.* at 7.

¹⁸ *Id.* at 7-8.

¹⁹ *Id.* at 8.

attempt to collect through a court action, Mr. Carr included the annual revenues associated with these customers as a bad debt expense.²⁰

Adjustment No. 7. Life Insurance Expense.

Mr. Carr annualized the cost of life insurance based on the most recent quarterly premium paid by the Company to be \$2,424.²¹ Twenty-five percent of this amount, or \$606, was added to the Company's operating expenses.²² Mr. Carr included only twenty-five percent to reflect that Mr. Winney works only part-time for the utility.²³

Adjustment No. 8. Auto Insurance Expense.

Mr. Carr annualized the cost of auto insurance based on the most recent insurance premium to be \$408.²⁴ Based on Company estimates for utility-use miles and total actual annual mileage, 37.49% of the total annualized premium was included in operating expenses.²⁵

Adjustment No. 9. Gasoline Expense.

Mr. Carr adjusted total annual gasoline expense to reflect utility use of 37.49%.²⁶

Adjustment No. 10. Other Auto Expenses.

Mr. Carr adjusted total other auto expenses, such as repairs, to reflect utility-use of 37.49%.²⁷

Adjustment No. 11. Electricity Expense.

Mr. Carr annualized electricity expense based on ten recent monthly electricity bills.²⁸

Adjustment No. 12. Bank Service Charges.

Mr. Carr eliminated all bank service charges because he considered such charges as non-recurring given the Company's level of rates and revenue.²⁹

²⁰ *Id.*

²¹ *Id.* at 8, Appendix at 5.

²² *Id.*

²³ *Id.* at 8.

²⁴ *Id.* at 9, Appendix at 6.

²⁵ *Id.*

²⁶ *Id.* at 9.

²⁷ *Id.*

²⁸ *Id.* at 10.

²⁹ *Id.*

Adjustment No. 13. Telephone Expense.

Mr. Carr annualized local telephone expense and recommended that the Company be ordered to retain its itemized long distance bills, along with a log of all long distance calls, stating the date, party called, and business purpose.³⁰

Adjustment No. 14. Depreciation Expense.

Consistent with the Commission's Rules Implementing the Small Water or Sewer Public Utility Act established in Case No. PUE870037, Mr. Carr calculated depreciation expense by multiplying the end of test year amount of depreciable plant by a composite depreciation rate of three percent.³¹

Adjustment No. 15. Contributions In Aid of Construction ("CIAC") Amortization Expense.

Mr. Carr used the composite rate of three percent to derive amortization expense on the end of test year CIAC.³²

Adjustment No. 16. Payroll Tax Expense.

Mr. Carr included FICA, Federal Unemployment Tax, and State Unemployment Tax expenses based on the \$5,000 salary added in Adjustment No. 4.³³

Adjustment No. 17. Property Tax Expense.

Mr. Carr annualized property tax based on the most recent bills for the Company vehicle (utility portion, only) and utility property.³⁴

Adjustment No. 18. Utility Plant.

Mr. Carr adjusted utility plant to reflect the balance used in the Company's last case, updated for any subsequent capital improvements.³⁵

Adjustment No. 19. Accumulated Depreciation.

Mr. Carr calculated accumulated depreciation by assuming depreciable plant was placed in service in the midpoint of each year.³⁶

³⁰ *Id.*

³¹ *Id.* at 13.

³² *Id.*

³³ *Id.* at 11.

³⁴ *Id.*

³⁵ *Id.* at 12, Schedule A.

³⁶ *Id.*

Adjustment No. 20. CIAC.

Mr. Carr determined the level of CIAC by adding all connection fees collected by the Company since the purchase of the system.³⁷

Adjustment No. 21. CIAC Accumulated Amortization.

Mr. Carr increased rate base by \$409 to reflect derived CIAC accumulated amortization.³⁸

Finally, Mr. Carr noted that he did not include any federal income tax expense or gross receipts tax expense in the Company's operating expenses.³⁹ Because the Company is a Subchapter S Corporation, it pays no federal income taxes.⁴⁰ Moreover, because the Company is not incorporated as a public service company, it has no gross receipts tax liability.⁴¹

Based on these adjustments, Mr. Carr calculated test year operating income produced by current rates to be \$5,484.⁴² In addition, Mr. Carr computed total rate base as of the end of the test period to be \$33,267. As discussed below, Staff witness Stevens recommended eliminating collection of the availability fee. Mr. Carr showed that if Mr. Stevens' recommendation is adopted, the Company would have an annual operating income of \$4,404. Mr. Carr concluded, "[b]ased on this level of operating income, Staff believes that the Company's proposed water service rate increase is unnecessary and should be denied."⁴³

Mr. Stevens presented testimony on the Company's recent quality of service history and its standing with the Virginia Department of Health ("VDH").⁴⁴ Mr. Stevens reported that on March 30, 2000, the State Health Commissioner issued a "Special Order" in which the State Health Commissioner found that Mr. Winney:

1. Allowed the addition of waterlines to the waterworks without an approved construction permit;
2. Failed to provide a minimum of 20 psi of pressure at all service connections under all conditions of flow;
3. Failed to provide a minimum of 200 gallons of storage volume per equivalent residential connection;

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 11.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.* at Statement I.

⁴³ *Id.* at 13.

⁴⁴ Exhibit JAS-3.

4. Exceeded the Primary Maximum Contaminant Levels (PMCL) for microbiological contaminants based on the presence of coliform bacteria on numerous occasions;
5. Failed to submit quarterly operations reports to VDH on numerous occasions;
6. Failed to collect and have analyzed the requisite water samples on numerous occasions; and
7. Failed to maintain and operate the waterworks in a competent, clean, and orderly manner that promotes public health and confidence in the ability of the waterworks to provide safe drinking water.⁴⁵

According to Mr. Stevens, on February 1, 2001, Mr. Winney “was criminally prosecuted and found guilty in the General District Court of Franklin County for violating the State Health Commissioner’s March 30, 2000 Order.”⁴⁶

Mr. Stevens provided several letters, which documented service problems related to the Company.⁴⁷ Included in these letters was a November 4, 1999, letter from Mike Painter, acting district engineer for the VDH to Mr. Winney advising him that the VDH “will not recommend further connections to the waterworks until certain informational and operational issues are adequately addressed by your Company.”⁴⁸ Based on this information, Mr. Stevens argued that “the Company’s availability charge is no longer necessary or justified.”⁴⁹

Similarly, Mr. Stevens opposed the Company’s request for a connection fee of \$1,000.⁵⁰ Mr. Stevens based his opposition to a connection fee for the Company on two considerations. First, Mr. Stevens provides evidence that despite VDH’s recommendation against new connections, Mr. Winney has continued to make new connections.⁵¹ Thus, Mr. Stevens concludes that allowing Mr. Winney to charge a connection fee will encourage him to ignore “the VDH’s moratorium on new service connections.”⁵² Second, Mr. Stevens contended that the Company does not incur any costs related to new connections.⁵³ Customers making connections to the Company’s system must hire a plumber to make the actual connection.⁵⁴ Mr. Stevens stated that connection fees approved by the Commission historically have been based on costs

⁴⁵ *Id.* at 5.

⁴⁶ *Id.*

⁴⁷ *Id.* at Attachments.

⁴⁸ *Id.* at Appendix A, page 1.

⁴⁹ *Id.* at 4.

⁵⁰ *Id.* at 6-8.

⁵¹ *Id.* at 6-7.

⁵² *Id.* at 7.

⁵³ *Id.*

⁵⁴ *Id.* at 8.

incurred by the utility to connect the new customer.⁵⁵ Finally, Mr. Stevens points out that even without incurring any cost, and without having an approved connection fee, Mr. Winney has tried to collect connection fees from customers.

DISCUSSION

The accounting and ratemaking adjustments proposed by Staff witness Carr appear to follow established Commission precedent and procedures. For example, Mr. Carr did not include a federal income tax expense for the Company because it is a Subchapter S Corporation, which is not taxed at the corporation level. Mr. Carr's recommendation is consistent with the Commission's decision in *Application of Pelham Manor Water Supply Company, Inc., for a certificate of public convenience and necessity*, Case No. PUE960129, 1998 S. C. C. Ann. Rep. 333, 334 ("*Pelham Manor*"). In *Pelham Manor* the Commission found:

Although the issue of federal income tax was not raised in the Company's comments and exceptions, it was raised at the hearing. We note that, for federal income tax purposes, Pelham Manor is an S Corporation. Therefore, the Company does not have an income tax liability; rather the income of the Company is included in the personal income tax return of the owner. . . . We agree with the Hearing Examiner and Staff that the tax adjustment requested by Mr. Travers should not be part of the Company's cost of service.⁵⁶

Generally, Mr. Carr annualized costs associated with providing water service based on test year-end levels of customers and plant in service. In addition, Mr. Carr adjusted costs to reflect the most recent costs and assessments. Based on a review of Mr. Carr's proposed adjustments, I agree with his findings that for the test year ended November 30, 2000, for ratemaking purposes, the Company had annual operating revenue of \$16,440; total operating expenses of \$10,956; operating income of \$5,484; total rate base of \$33,267; and a return on rate base of 16.484%.⁵⁷ In addition, I agree with Mr. Carr's other accounting recommendations, which are designed to improve the accuracy of the Company's books and records.

Based on the accounting testimony provided by Mr. Carr, I find that the Company's requested increase in rates should be rejected and that the Company should continue to use its previously approved rates.

Staff witness Stevens raised two issues. First, Mr. Stevens recommended that the Company discontinue collecting its annual availability charge. Second, Mr. Stevens recommended against establishing a connection fee for the Company.

⁵⁵ *Id.* at 7.

⁵⁶ *Pelham Manor* at 334.

⁵⁷ Exhibit PWC-2, Statement I.

Availability Charge

In its July 6, 2001, Order Remanding Case to Examiner, the Commission noted that in *B&J Enterprises, L.C.*, Case No. PUE990616, “an availability charge could be applied only when the customer had contracted to pay the charge.”⁵⁸ The Commission further stated that in this case, because Staff raised questions and provided supporting testimony concerning a specific charge previously approved, the matter should continue to hearing.⁵⁹ However, the Commission placed the burden of proof upon the Staff.

The Staff will bear the burden of producing evidence that the availability charge is no longer just and reasonable or that the required contractual basis for such a charge can not be established.⁶⁰

In his testimony, Mr. Stevens did not raise as an issue or provide any evidence concerning the contractual basis for the Company’s availability charge. Instead, Mr. Stevens based his opposition to the availability charge on a VDH recommendation that no additional connections be made to the Company’s system.⁶¹ Mr. Stevens appears to interpret the VDH recommendation that no additional connections be made, to be a moratorium on new connections. Indeed, as quoted above, Mr. Steven explicitly refers to the VDH recommendation as a “moratorium.”⁶²

Mr. Stevens supports his testimony concerning the VDH recommendation with four attached documents. The first letter was dated November 4, 1999, from Mike Painter, P.E., acting district engineer, to Mr. Winney.⁶³ In this letter, Mr. Painter declared: “in a memo dated 18 October 1999, this Office stated that it will not recommend further connections to the waterworks until certain informational and operational issues are adequately addressed by your Company.”⁶⁴

The second document to Mr. Winney was a VDH Groundwater Sanitary Survey Report signed by Robert R. Deitrich, environmental inspector, regarding an inspection dated October 20, 1999.⁶⁵ In the first paragraph of this report, Mr. Detrich stated:

The waterworks ability to adequately serve current and future service connections is in question due to recent complaints from customers regarding water leaks, low tank levels and water outages. As a result, a thorough review of the waterworks is being conducted by this department. At this time this department is

⁵⁸ Order Remanding Case to Examiner at 2.

⁵⁹ *Id.* at 3.

⁶⁰ *Id.*

⁶¹ Exhibit JAS-3, at 3-4.

⁶² *Id.* at 7.

⁶³ *Id.* Appendix A, at 1-2.

⁶⁴ *Id.* Appendix A, at 1.

⁶⁵ *Id.* Appendix A, at 3-4.

recommending that no new connections be added to the waterworks until it is determined that adequate service can be provided. This department will be contacting you in the near future as part of formal enforcement actions deemed necessary to bring the waterworks into compliance with the Waterworks Regulations.⁶⁶

The third letter was dated November 4, 1999, and was from Mr. Painter to Mr. Donnie Beard, Franklin County building official.⁶⁷ In this letter, Mr. Painter requested that “no additional connections to the waterworks be allowed until we have an indication from the waterworks owner about the current number of connections served and water usage.”⁶⁸

The fourth letter was dated November 23, 1999, and was from Mr. Painter to Mr. John Hyder, environmental health specialist with the Franklin County Health Department.⁶⁹ In this letter it appears that Mr. Winney has satisfied some of the reporting requirements of the VDH.

[VDH] recently received information requested from Robert A. Winney regarding the number of connections to the subject waterworks. . . . Based on the information provided, this is to advise that the Department has no objections to the additional connection to the Starwood/Lakemount/Overlook Subdivision waterworks for Lot 12 in Section II of the Overlook development

Due to the ongoing issues being addressed with Mr. Winney about the operation and maintenance of the subject waterworks, as well as pressure concerns at some locations in the distribution system, the Department will continue to evaluate additional connections to the waterworks on a case-by-case basis.⁷⁰

Based on these letters it appears that the VDH may discourage new connections to the Company’s system, but evaluates requests on a case-by-case basis. This assessment is supported by a letter dated February 6, 2001, from Greg T. Flory, district engineer for VDH to a customer seeking approval of a new connection.⁷¹ In this letter, Mr. Flory reiterates that due to concerns over the reliability of the system and Mr. Winney’s failure to report the number of current connections and average daily water usage as required, VDH has recommended that no additional service connections be made to the system.⁷² Nonetheless, the connection requested

⁶⁶ *Id.* Appendix A, at 3.

⁶⁷ *Id.* Appendix A, at 5-6.

⁶⁸ *Id.* Appendix A, at 5.

⁶⁹ *Id.* Appendix A, at 7.

⁷⁰ *Id.*

⁷¹ *Id.* Appendix C, at 2.

⁷² *Id.*

by the customer was approved and the customer was advised that any additional connections to the system will be reviewed on a case-by-case basis.⁷³

Based on the evidence, I find that VDH's recommendation against connections to the Company's system does not amount to a moratorium against connections as depicted by Mr. Stevens. Rather, VDH's recommendation appears to be more a function of Mr. Winney's inability to meet VDH reporting and operating requirements. The fact remains that VDH continues to approve connections to the Company's system. Therefore, I find that Staff has not proven that the availability charge is no longer just and reasonable or that the required contractual basis for such charge can not be established.

Connection Charges

Mr. Stevens recommended against establishing a connection charge for the Company. Of his arguments, the most persuasive is that the Company incurs no costs in relation to new connections. Prospective new customers are required to seek approval of the connection from VDH and must hire and pay for a plumber to make the actual connection. Put simply, there are no costs for the Company to recover through a connection fee. Accordingly, I find that no connection fee should be established at this time.

In summary, based on the record, I find that the Company should maintain its currently approved rates and rate structure.

FINDINGS AND RECOMMENDATIONS

In conclusion, based on the evidence received in this case, I find that:

- (1) The use of a test year ending November 30, 2000, is proper in this proceeding;
- (2) Waterworks' test year operating revenues, after all adjustments, were \$16,440;
- (3) Waterworks' test year operating revenue deductions, after all adjustments, were \$10,956;
- (4) Waterworks' test year operating income, after all adjustments was \$5,484;
- (5) Waterworks' current rates produce a return on adjusted rate base of 16.484%;
- (6) Waterworks' adjusted test year rate base is \$33,267;
- (7) Waterworks' current rates are just and reasonable;
- (8) Waterworks should be required to refund, with interest, all revenues collected under its interim rates in excess of the amounts found just and reasonable herein;

⁷³ *Id.*

- (9) Waterworks should be required to refund, with interest, all interim connection charges collected;
- (10) Waterworks should be required to maintain its books in accordance with the Uniform System of Accounts for Class C water utilities;
- (11) Waterworks should apply a 3% composite rate to all depreciable plant balances and to contributions in aid of construction;
- (12) As of the end of the test year, any owner-provided vehicle loans, mortgages, or other loans that may be reflected on the Company's books and records have been paid in full and should not be an issue in future proceedings;
- (13) Waterworks should maintain property records on capitalized plant items;
- (14) Waterworks should maintain logs of its owner's time detailing services provided, long distance telephone logs, and mileage logs for use of the Company truck;
- (15) Waterworks should file an Annual Financial and Operating Report with the Commission's Division of Public Utility Accounting each year;
- (16) Waterworks should maintain its existing rates and rate structure, including its annual availability charges; and
- (17) Staff should continue to monitor the efforts of Waterworks to comply with the requirements of the Virginia Department of Health Office of Water Programs.

In accordance with the above findings, ***I RECOMMEND*** the Commission enter an order that:

1. ***ADOPTS*** the findings in this Report;
2. ***GRANTS***, and makes permanent, the rates requested by Waterworks; and
3. ***DISMISSES*** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

COMMENTS

The parties are advised that pursuant to Rule 5 VAC 5-20-120 C of the Commission's Rules of Practice and Procedure, any comments to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen copies, within twenty-one days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P. O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a

certificate to the foot of such document that copies have been mailed or delivered to all other counsel of record and to any party not represented by counsel.

Respectfully submitted,

Alexander F. Skirpan, Jr.
Hearing Examiner